REPRINTED FROM THE
TUESDAY, APRIL 12, 2005
NEW YORK
Real Estate Journal
COVERING ALL OF LONG ISLAND, NEW YORK CITY AND UPSTATE NEW YORK

The importance of business expenses and future financing

By Vipin Thakral, T&T Commercial Capital, LLC

We live in a corporate world filled with one line phrases. My top ten would definitely include:

"Hit a Home Run";

"Win/Win Situation";

"Keep Me in the Loop" and of a course, who could live without

"Think Out of the Box".

However, there is one phrase that I often find myself reiterating to my clients, friends, family members or whoever else will listen and strangely enough, this saying wasn't invented by the corporate world. In fact, I don't even know who coined the phrase, but I'll never forget the following advice I received from a very wise man, my father:

"Do not cut off your nose to spite your face"

I do not know where this phrase is more appropriate than in the world of business income taxes. We live in a society today in which paying income taxes is a taboo. This especially holds true for self-employed individuals/small business owners. We reach out to our accounting professionals every spring in hopes of finding the newest potion for reducing business income and thereby paying less in taxes. We research the latest trends and consult our tax software so that we can maximize our deductions and keep them within industry norms. We make sure to capture (inflate) these deductions on our respective corporate returns or Schedule C (Net Profit from Business) for unincorporated businesses.

The typical small business owner isn't worried about obtaining routine financing. As long as they have good credit; securing credit cards, obtaining financing for a car or even purchasing a home is routine. The low income figure that they have been reporting is rarely a road block. For example, in the case of a residential mortgage, they can always qualify for a "Stated Income" program that is offered by most residential mortgage bankers/lenders. This program allows the business owner to actually state their income, which is not verified. As long as the income is within industry norms (which are very subjective) and they can produce some type of business documentation (such as a business license, articles of incorporation, business bank statements or a CPA letter), they can qualify. The interest rates on stated income programs are on average 0.50% higher than full income documentation programs, which require you to produce the actual filed tax returns. The banker/lender is relying on the respective business owner's solid credit history as assurance for subsequent debt payment and the borrower (small business owner) is more than satisfied with the minor interest rate adjustment.

In the world of commercial lending, stated income programs are not readily available and even if you have superb credit, you still must provide valid cash flow documentation to support payment of the commercial loan. The bottom-line is that this approach could cause a significant financing dilemma to small business owners that are looking to purchase owner occupied commercial real estate in the near future.

Let's take for example a two-partner insurance agency that rents space and reports $140,000 in net income after taxes which includes $60,000 in questionable deductions. The partners would like to purchase a $1 million building for the business at 7.0% with a 30 year term. The monthly payment for debt service (excluding insurance and taxes) would be approximately $6,650 a month or $80,000 annually. Let's also assume that the real estate taxes, insurance payments, maintenance, utilities and overhead associated with the purchase are offset by the decrease in rental expense and all other expenses remain constant. It might be difficult to convince a commercial lender that the two partners could satisfy their personal needs with only $30,000 a year. However, if you increase the net income of the insurance agency by $60,000 or $30,000 per individual, maybe the commercial lender would reconsider the deal. Obviously, there would be a tax consequence related to increased income, but this would be a small price to pay for obtaining the required financing.

Therefore, next time you take a business deduction for the car lease belonging to your wife, make certain purchases that should be capitalized, or deduct routine family dining as meals and entertainment, MAKE SURE YOU:

1. Take into consideration your future plans;

2. Obtain sound advice from a commercial business advisor and always remember

3. "Don't cut off your nose to spite your face."

Vipin Thakral, MBA, CPA is chief operating officer of T&T Commercial Capital, LLC, Queens Village, N.Y.